1-1-1980

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The Current Need For A New Candid Legal Standard Recognizing Broad Corporate Social Responsibility

RODMAN M. ELFIN*

THE PRESENT MANIFESTATION OF THE PROBLEM

The pressures are becoming intense for the recognition of social responsibility as a legal standard to guide business, and for a consequent rejection of profit maximization as the sole legal standard of business guidance. The situation exists because of the tremendous power of our large corporations and the impact of the use, or lack of use, of such power upon our society.

Currently this pressure exists in three significant areas. First, business managers of university and other trust funds are being urged to divest their funds of shares of stock in corporations with substantial activity in South Africa and Namibia because those countries have racial policies which are contrary to the moral and ethical beliefs of students and other activists. Thus, divestiture is urged solely to advance a social cause, despite the fact that such action may result in expense and a lowering of income to the trust. By way of example, Harvard recently

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announced that it opposed divestiture not merely, or even primarily, because it costs the university money, but because Harvard believes that, contrary to the position of the social activists, divestiture is a "relatively ineffective means of pursuing ethical ends." Nevertheless, it would consider "divestiture in the case of a corporation that offered no hope of changing its behavior in South Africa to meet its ethical responsibilities." In Ohio, Miami University trustees voted to sell the university's stock in Union Carbide Corporation, and the Warner-Lambert Company, because they have operations in South Africa. This was in response to a resolution for divestiture proposed by a student-faculty "Committee Against Apartheid" and approved in a student referendum. In May 1978 students demonstrating against investments in South Africa staged a sit-in at the graduate school of business at Columbia University. On the same day, a university Senate committee announced its recommendations on the issue "including proposals for divestiture of stock in companies that demonstrate 'indifference to oppressive racial policies.'" The University of Washington adopted a new investment policy "that allows consideration of human rights concerns in addition to its primary objective of getting maximum return at minimum risk." Divestiture is being debated at many other universities, including the Universities of Massachusetts and Wisconsin, Princeton, and Stanford.

With respect to the management of their portfolios, as opposed to their educational activities, university trustees share the same objectives and have the same responsibilities as profit-seeking corporations. They recognize the legal as well as the business and social issues involved. Harvard's portfolio includes $300 million in companies with business connections in South Africa. In April 1979 Harvard's President Derek Bok referred to the legal problems facing portfolio managers who buy and sell on political rather than financial grounds. He said that "[t]otal divestment would almost certainly cause the university to divert millions of dollars in pursuit of a strategy that is legally questionable. . . ." A recent editorial in the New York Times reported that by avoiding or unloading such holdings, a university might well risk millions in income and corporate gifts. The Times editorial states: "The imperfect answer for these trustees is that they have to draw the line by

2. Id.
3. Id. at 9, col. 2.
4. Id.
5. Id. at 9, col. 3.
6. Time, April 16, 1979, at 104, col. 3.
their own evolving standards of social responsibility, with due regard for deeply-held convictions in their communities.\textsuperscript{8}

Secondly, in the spring of 1978, President Carter asked management and labor for voluntary price and wage restraint in order to combat inflation. American Telephone and Telegraph, for example, responded with an announcement of a freeze on the price of phone equipment. The business, social, and political climate is typified by a New York Times editorial which states in part: “[I]f enough key companies comply with the call for voluntary restraint, a genuine dent might be made in the inflation rate. . . . [T]he old ways of courting inflation have performed badly; a new way would be welcome.”\textsuperscript{9}

In June 1978, responding to the same need, “Bethlehem, the nation’s second largest steelmaker, announced that it would scale back an anticipated 7% price increase, set for July, to a flat 3%. Moreover, the company pledged to forego any additional price hikes this year, if the President’s anti-inflation strategy of voluntary cooperation from industry and labor begins to slow the alarming spiral in the cost of living.”\textsuperscript{10} Presidential assistant Robert Strauss “promptly hailed Bethlehem’s action as a ‘major breakthrough’ and an example of ‘good corporate citizenship.’”\textsuperscript{11} Kaiser Aluminum and Ford Motor Company have also put a lid on prices.\textsuperscript{12}

Thirdly, on a more ongoing basis, there are the substantial forces that play on businesses and on business people, both in their capacity as corporate executives and as individuals, in an attempt to solve long range social problems such as pollution control and widespread malnutrition. Legal standards for pollution control are arrived at, in large part, as a result of compromise between environmentalists and profit-oriented business. To view the formation of the standards and their application as strictly the result of two diametrically opposed interests is, however, simplistic. A segment, at least of top management, being informed, interested, and moral persons, as well as efficient business managers, are concerned with the environment in a positive sense; and are desirous of improving that environment beyond the point of merely complying with legal standards, often established by compromise, with interests that place greater emphasis on profits.

A specific example of the attitude of many modern business execu-

\textsuperscript{8} Id.
\textsuperscript{9} Id., May 28, 1978, at 14E, cols. 3, 4.
\textsuperscript{10} TIME, June 26, 1978, at 50, col. 1 (emphasis added).
\textsuperscript{11} Id. at 50, col. 1.
\textsuperscript{12} Id.
tives is that of Thomas Wyman, President of Green Giant Company, a food processor with sales approaching $500 million.

An outspoken executive, he often rebukes business for high-polluting plants, unsafe products, underfunded pensions, and overseas bribes. Despite such visible failings, he argues, there is far more talent in business than in politics, and therefore business should do much to solve global problems, including malnutrition. This is both the right and the smart thing to do, he reasons, and business should be willing to accept less than its usual profit, since Third World pressures will disrupt Western economies if hunger continues.\(^\text{13}\)

The related question of who should pay for corporate altruism was highlighted in July 1978, when the Washington Utilities and Transportation Commission was urged to scrap a policy under which it allows utilities to include charitable contributions in the base used to set consumer rates. The Commission accounting analyst challenged the inclusion of $479,000 in charitable contributions in the rate base of Pacific Northwest Bell. The Commission analyst’s contention is that if charitable contributions are charged as an operating expense, the ratepayer is forced to pay higher rates but with no ratepayer benefits and with no opportunity to determine the recipients of the amounts for which the ratepayer is charged. The Commission set the charitable contribution policy in 1976 in Bell’s previous rate increase request and in another order granting General Telephone Company a rate boost. In those orders, the Commission pictured Bell as responsible corporate neighbors throughout the state of Washington, and said “all businesses are expected to contribute to social and charitable programs.”\(^\text{14}\) The Commission also remarked that the lack of contributions would be strongly felt in smaller communities around the state. Editorial treatment, the day after this announcement, took the position that building this expense into the rate structure was a serious wrong, and that Pacific Northwest Bell should not be able to make its customers pay for its charitable contributions. The company, on the other hand, claims that other businesses make contributions of various kinds which they include in the price of their goods.\(^\text{15}\) The question here is whether the customers or the shareholders should bear the expense of these charitable contributions,\(^\text{16}\) and, potentially, should the contribution be made at all.

\(^{13}\) Id. at 51, col. 2.


\(^{16}\) It is interesting that this is still an active question. In 1934, the Supreme Court of Oklahoma considered this very question and held that a gas company was not entitled to an increase in its gas rate to enable it to make donations or contributions to charitable or civic causes. Carey v. Corporation Comm’n, 168 Okl. 487, 33 P.2d 799 (1934).
In all three of these areas the legal question is the same. There is a growing recognition that the problems of our society cannot be solved by government alone. Business is involved in the solution of social and political problems, and this involvement requires a decision to use corporate funds, or to reduce profits, in order to attain social or political aims. Despite this development in corporate activity, a difference exists between corporate practice and generally recognized corporate law. Historically, profit maximization for the benefit of the shareholder has been the standard applied by the law. The question raised by the involvement of business in these pressing social issues is: to what extent may management use corporate funds, or forego profits, in order to achieve what it conceives to be its social responsibility, in view of the conflicting right of shareholders to receive maximum dividends?

Intellectually, the question is not new. Professor E. Merrick Dodd raised the basic issue of the social responsibility of business in 1932.17 In 1961, Justice Frankfurter noted in a dissenting opinion that “a contested question in the corporate field is the legitimacy of corporate charitable contributions.”18 In substantial part, the contribution to organized charity has been dealt with by legislation, but that legislation has not resolved the larger issue of general corporate social responsibility raised above.

THE DEVELOPMENT, STATUS, AND PREDICTED FUTURE OF PERMISSIBLE CORPORATE ALTRUISM

Because of the current social pressures noted above, it is at this time necessary to examine the development of the law and the present status of legal authority for corporate action in the field of business social responsibility. It is necessary, also, to anticipate the future development of the law so that a framework will exist for the resolution of those questions raised above, as well as similar questions in such fields as urban problems, poverty, and race relations, with which business is becoming increasingly involved.

The development of the law in this area has been hindered by the natural tendency of businesspeople, regardless of what may be an altruistic motive for their social behavior, to justify their action on the basis of at least long-term profit potential. Thus, they are often able to avoid the legal question of compliance with the standard of profit maximization. The issue is further complicated by the fact that, in reality, corpo-

17. Dodd, For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145 (1932).
rate judgment may be based on several elements, some altruistic and some profit oriented.

What has been described as corporate "good citizenship" and real concern for the solution of broad social problems, with respect to the large corporation at least, often merges with and becomes indistinguishable from a concept of long-term profit potential. Thus, a corporation can contend with logic that its ability to operate profitably is affected by the social and political, as well as the economic, environment in which it operates. In fact, the initial short-term advantage to the corporation which employs all of its resources for profit maximization may be lost, in the form of good will, to the corporation which recognizes that the kind of society necessary to sustain profits must be nurtured by the kind of activity which can often be called either long-term profit orientation or altruism. Also, when the public expects business to assume social responsibility, this becomes a factor related to good will that a profit-oriented business executive must consider.

The starting point in a discussion of the legal parameters of a corporation in relation to expenditure of funds not related to profit maximization is the landmark case of *Dodge v. Ford Motor Co.* The Ford, the dominant shareholder, announced that in large part the business would henceforth be devoted to the reduction of prices to the consumer and to expansion so that more jobs would be provided for workers. It was Ford's intention to spread the benefit of our industrial system by increasing employment, and to reduce dividends in order to discharge a public obligation to keep prices down. This was characterized as a humanitarian motive. Ford's purpose was altruistic. The Michigan Supreme Court compelled Ford to continue, instead, to pay large dividends. The court stated:

> A business corporation is organized and carried on primarily for the profit of the shareholders. The powers of the directors are to be employed for that end. The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

The *Dodge* decision would seem to foreclose the possibility of altruistic activities by corporate managers. The philosophy of that decision is simply stated by Fletcher:

> A gift of its property by a corporation not created for charitable purposes is in violation of the rights of stockholders and is ultra vires

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20. *Id.* at 507, 170 N.W. at 684, 3 A.L.R. 413, 441 (1919).
however worthy of encouragement or aid the object of the gift may be.\footnote{21}

All of the states have treated the traditional philanthropic contribution by some form of statutory authorization which empowers the making of specified contributions. These statutes authorize certain altruistic activities apart from the benefit rule. Most of the states have modeled their statute after section 4(m) of the Model Business Corporation Act. The 1969 Text as amended to 1977 provides under the heading “General Powers”: “Each corporation shall have power: . . . (m) To make donations for the public welfare or for charitable, scientific or educational purposes.” The Model Act does not attempt to restrict the amount or source of a donation. Two states\footnote{22} authorize only those donations which are “reasonable,” and three states\footnote{23} limit donations to the percentage of taxable income which a corporation may deduct under federal income tax law. Most of the states use the words “charitable, educational, scientific, and public welfare.” A lesser but substantial number use the word “religious,” and a still lesser but significant number use the word “civic.” A sprinkling of other words are used by a few states such as “artistic,” “hospital,” “literary,” “patriotic,” “philanthropic,” “welfare,” and “benevolent.” Two states\footnote{24} use the words “social and economic betterment.”

To the extent therefore that an expenditure of corporate funds, which has its root in a desire to discharge “social responsibility,” falls within the traditional classification of “charitable, educational, scientific, public welfare,” or other specific terminology noted above, there is express statutory authorization. When, however, we approach the use of or loss of funds for such purposes as affecting racial discrimination in South Africa, voluntary price restraint to combat inflation, pollution control beyond legislative requirements, or correcting malnutrition in Third World countries, as well as other pressing social problems, these activities cannot be easily fitted into the usual statutory classifications. Closest in point, of course, is the wording “public welfare” used in most but not all states, and “betterment of social and economic conditions” used in two states. There is little authority defining these words. One court, considering a statute similar to the Model Act, and where the recipient of the gift was characterized as possibly a “pet charity,” held that the

\footnotesize{21. Cyclopedia of Corporations, Perm. Ed. §2939 at 667. \textit{See also} Annot., 3 A.L.R. 443(1919).}

\footnotesize{22. MD. CORP. & ASS’NS CODE ANN. §2-103; OKLA. STAT. ANN. tit. 18, §1.19 (West).}

\footnotesize{23. IND. CODE ANN. §23-1-2-17 (Burns); S.C. CODE ANN. §33-3-20; VT. STAT. ANN. tit. 11, §108.}

\footnotesize{24. NEB. REV. STAT. §21-2004; N.J. STAT. ANN. §14A:3-4 (West). Note that the New Jersey statute using this language was adopted in 1969, after the decision in \textit{A.P. Smith Manufacturing Co. v. Barlow}, 13 N.J. 145, 98 A.2d 581 (1953).}
The test to be applied is one of reasonableness.25

Because government has in recent times sought the active participation of business to cure social ills, the 1969 version of the Model Act added section 4(n), which empowers corporations "[t]o transact any lawful business which the board of directors shall find will be in aid of governmental policy." As this is adopted by state legislatures, the creation or confirmation of the power of a corporation to act "in aid of governmental policy," without finding such power in common law, will go far to legitimize many corporate activities in the social sphere. It will not help, however, in those instances where corporate social action cannot be shown to follow a predetermined governmental policy. As a matter of fact, the adoption of section 4(n) may by implication serve to limit lawful corporate social action to those instances where government has first established a policy. Corporations may therefore be prevented from leading the way into areas of social need. It would be unfortunate if our society solidified into a system where large repositories of power and wealth, our public corporations, could not on their own initiative select programs and aims deemed socially desirable.

A lingering question is the effect of the statutes that legalize specific corporate activity upon corporate social activity that cannot reasonably be included in the specific categories set forth in the statutes. Should such statutes be construed to invalidate by implication social activity not specifically authorized by the statute, but that would have been permissible under common law? Such a view is certainly arguable. An equally valid contention is that the statutes are intended to confirm the validity of certain corporate activity, without making invalid what would be permissible under common law. No authority has been found specifically addressed to this point.

The evolution of social thinking over the period 1919 to 1953 culminated in recognition by the Supreme Court of New Jersey of corporate responsibility to the community as the legal justification for a contribution to Princeton University, without reliance upon a statute and without reliance upon a showing of benefit to the donor. In A.P. Smith Manufacturing Company v. Barlow,26 although the court could have sustained the contribution on narrow grounds, it did so in the context of social responsibility. The court stated that "modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate.27

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27. Id. at 154, 98 A.2d at 586.
The corporation first attempted to bring the contribution within the economic benefit test by showing that the contribution was designed to enhance the corporation’s good will, and to assure a flow of trained personnel for corporate employment, and to bolster free enterprise through education. The court emphasized that it is required to take notice of changed circumstances which require adjustment of our legal doctrines, and stated that charitable institutions have become dependent on corporate giving as more and more wealth has been concentrated in corporations. The court found that the contribution could be justified under the common law benefit test by stretching benefit to include long-term survival in a free enterprise system. The benefit required under the common law test was found in the relationship between the gift to higher education and its effect on the educational system and the very survival of the corporation in a free enterprise system. It must be noted that this claimed benefit is not in fact related to increase in business revenues or to cost reduction, except perhaps in a most remote sense. It can be termed a legal fiction. *More importantly, however, the court found that the power of corporations to make contributions existed apart from express statutory conditions.*

*Union Pacific Railroad Co. v. Trustees Inc.*, a 1958 case, involved a contribution not authorized by the corporate charter. The Supreme Court of Utah justified its holding that there was implied power to make the contribution on the ground that corporations in modern society are the repositories of the wealth that is available to support, for example, educational, charitable, or religious institutions, and that in response there has been born a new corporate business policy. This policy involves the use of funds for worthy causes just as other funds are earmarked for advertising or public relations. The Chairman of the Board of Union Pacific Railroad Company testified: “I think the public has come to expect that we will support worthwhile local and national causes, and in effect we agree with this viewpoint.” The court, after going out of its way to sustain the gift on the grounds noted above, also considered that it was for the best interests of the company and its shareholders. The language of the dissent is particularly significant as it recognizes the ultimate truth of much corporate activity in the social sphere. The dissent stated:

The main opinion suggests that the directors of appellant are “confident that their company presently and directly, or within the foreseeable future would receive a quid pro quo as the resultant of good will

28. *Id.* (emphasis added).
30. *Id.* at 106, 329 P.2d at 401.
engendered by contributions." *In my opinion it is impossible to declare that good will of any size or dimension or any good will whatsoever will result from the giving. In my opinion the real purpose, of these public spirited directors, is their desire to aid worthwhile causes that need their assistance.*

*Sylvia Martin Foundations Inc. v. Swearingen* involved a decision by Standard Oil of Indiana to float a bond offering overseas rather than in the United States. The decision required the corporation to pay a higher interest rate on its bonds than would have been required if the bonds were floated in the United States. Standard Oil made the decision in order to aid a severe United States balance of payments problem. The suit was dismissed on procedural issues. However, the court noted that the decision to aid the United States’ balance of payments problem could be sustained as a matter of business judgment. Note that the loss of funds here goes far beyond the usual definition of charitable contribution.

In *Shlensky v. Wrigley*, a minority shareholder of the Chicago Cubs baseball team challenged the corporation’s refusal to install lights at the stadium and schedule night games, which apparently would have increased profits. The corporation took this action because it believed that baseball is a daytime sport and that “the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood.” Relief was denied. The court found that the corporation’s decision *could have been* based on a concern that deterioration of the neighborhood would reduce patronage and not be in the long-run interest of the corporation.

In *Kelly v. Bell*, the Supreme Court of Delaware sustained a “donation” made by U.S. Steel Corporation to Pennsylvania County. This donation was allegedly made in recognition of the corporation’s responsibility to the community and, the court found, in its self interest. The court spoke in terms of benefit to the corporation, as well as in terms of the corporation’s social responsibility. Considering the facts of the case, it is apparent that the court could have justified its decision solely on the benefit theory. It is significant, therefore, that the court relied in addition on *A.P. Smith v. Barlow* and validated the payments as part of United States Steel’s social responsibility.

A common thread which winds through the cases decided since

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31. *Id.* at 111-12, 329 P.2d at 405 (emphasis added).
34. *Id.* at 176, 237 N.E.2d at 778 (emphasis added).
35. *Id.* at 180, 237 N.E.2d at 780.
Dodge v. Ford Motor Co. is that businessmen engage in, and the courts sustain, altruistic activity, but both businessmen and the courts feel constrained to justify the action as being of economic benefit to the corporation. It is interesting to note that few modern cases have actually held corporate officers or directors liable for ultra vires acts. A few cases have granted injunctions to shareholders to restrain contemplated ultra vires acts. Since the 1930's no court has actually invalidated corporate expenditures not related to profit except for political activities that were prohibited by statute. On the contrary, each test has resulted in affirmation of the corporate action, regardless of the grounds stated by the court.

Undoubtedly, due to the uncertainty of the law, judicial opinions on the subject speak in terms both of social responsibility and benefit. It is difficult to determine, therefore, whether the cases justify altruistic corporate expenditures under the benefit rule, or in spite of it. Because of the steady extension of the concept of benefit, it seems that any corporate act that benefits society is said to benefit the corporation and its shareholders. A greater latitude of course exists for corporate social expenditures in those states that permit donations for "public welfare" than in those which permit only the more traditional expenditures for "charitable, scientific or educational purposes." In either case, the activities permitted are in great need of clarification.

The concern of business with respect to authority for altruistic behavior was verbalized by John S. Sinclair, a director of the Union Pacific Railroad Company:

Because of the fear that if under common law no direct return can be shown, a dissenting stockholder may successfully charge the directors with giving away money that does not belong to them, legal counsel prefers to have legislative support for making contributions.

Where directors in fact pursue altruistic activities for the benefit of society, instead of seeking to maximize profits, and this course of action is frequently sustained, it is no longer possible to use candidly the director's traditional fiduciary duty to shareholders as the test of permissible corporate activity.

In one area at least, it has become clear that a corporation may spend money even though the expenditure will not have a material effect on its business. This area was considered by the United States Supreme Court in 1978 in the case of First National Bank of Boston v. Bellotti. The case is concerned with the first amendment and freedom of speech.

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The appellants, national banking associations and business corporations, wanted to spend money to publicize their views opposing a referendum proposal to amend the Massachusetts constitution to authorize the legislature to enact a graduated personal income tax. The action was brought challenging the constitutionality of a Massachusetts criminal statute that prohibited them from making contributions or expenditures for the purpose of influencing or affecting the vote on any question submitted to the voters, other than one materially affecting any of the property, business or assets of the corporation. The statute specified that "no question submitted to the voters solely concerning the taxation of the income, property or transactions of individuals shall be deemed materially to affect the property, business or assets of the corporation." The court held that there is no support in the first or fourteenth amendments or in Supreme Court decisions for the proposition that such speech loses the protection otherwise afforded it by the first amendment, simply because its source is a corporation that cannot prove, to a court's satisfaction, that it has a material effect on the corporation's business. Neither, the court held, could the statute be justified on the asserted ground that it protects the rights of shareholders whose views differ from those expressed by management on behalf of the corporation. The Supreme Court stated that the issue presented was one of first impression.

The statute, held unconstitutional, permitted a corporation to communicate to the public its views on certain referenda subjects—those materially affecting its business—but not others. It also singles out one kind of ballot question—individual taxation—as a subject about which corporations may never make their ideas public. The statute drew the line between permissible and impermissible speech according to whether there is a sufficient nexus, as defined by the legislature, between the issue presented to the voters and the business interests of the speaker. The court stated:

If a legislature may direct business corporations to "stick to business" it also may limit other corporations—religious, charitable, or civic—to their respective "business" when addressing the public. Such power in government to channel the expression of views is unacceptable under the First Amendment.

Mr. Justice White stated in the dissent that "the issue is whether a State may prevent corporate management from using the corporate treasury

41. Id. at 768; MASS. GEN. LAWS ANN. ch. 55, §8.
42. 435 U.S. at 784.
43. Id. at 790-92.
44. Id. at 784.
45. Id. at 785.
to propagate views having no connection with the corporate business. Justice White concluded that the majority opinion was in error by stating that:

The Court invalidates the Massachusetts statute and holds that the First Amendment guarantees corporate managers the right to use not only their personal funds, but also those of the corporation, to circulate fact and opinion irrelevant to the business placed in their charge and necessarily representing their own personal or collective views about political and social questions . . . .

Mr. Justice White sums up the impact of the majority opinion by stating:

As I understand the view that has now become part of First Amendment jurisprudence, the use of corporate funds, even for causes irrelevant to the corporation's business, may be no more limited than that of individual funds.

Further language in the dissent is significant because it represents the older views rejected by the majority.

The expenditure of funds to influence votes not related to the corporation's business was approved by the Bellotti court in spite of the fact that there was "no basis whatsoever for concluding that these views are expressive of the heterogenous beliefs of their shareholders." Are these shareholders without a remedy? The Supreme Court addressed that question and found they do have a remedy.

Ultimately shareholders may decide, through the procedures of corporate democracy, whether their corporation should engage in debate on public issues. Acting through their power to elect the board of directors or to insist upon protective provisions in the corpora-

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46. Id. at 803 (White, J., dissenting).
47. Id. (emphasis added).
48. Id. at 821.
49. Shareholders in such entities do not share a common set of political or social views, and they certainly have not invested their money for the purpose of advancing political or social causes. In fact, as discussed infra, the government has a strong interest in assuring that investment decisions are not predicated upon agreement or disagreement with the activities of corporations in the political arena.

Id. at 805 (White, J., dissenting).

In short, corporate management may not use corporate monies to promote what does not further corporate affairs but in the last analysis are the purely personal views of the management, individually or as a group.

Id. at 813 (White, J., dissenting).

Corporations, as previously noted, are created by the State as a means of furthering the public welfare. One of their functions is to determine, by their success in obtaining funds, the uses to which society's resources are to be put. A State may legitimately conclude that corporations would not serve as economically efficient vehicles for such decisions if the investment preferences of the public were significantly affected by their ideological or political activities. It has long been recognized that such pursuits are not the proper business of corporations. The common law was generally interpreted as prohibiting corporate political participation.

Id. at 818-19 (White, J., dissenting).

50. Id. at 806 (White, J., dissenting).
tion's charter, shareholders normally are presumed competent to protect their own interest. Further, the court stated: "[T]he shareholder invests in a corporation of his own volition and is free to withdraw his investment at any time and for any reason."\(^{51}\)

In the context of the first amendment, the Supreme Court advanced another argument which has force equal to the broader issues with which we are concerned. If the test of materially affecting the corporate business was allowed to stand, "management never could be sure whether a court would disagree with its judgment as to the effect upon the corporation's business of a particular referendum issue."\(^{52}\) This is especially so "when what must be established is a complex and amorphous economic relationship."\(^{53}\) In like manner, corporations as we have seen may be unduly hesitant to engage in advantageous social activity when management can never be sure that a court will agree that there is a sufficient nexus to a business purpose.

Until the 1978 decision of the United States Supreme Court in the case of *First National Bank of Boston v. Bellotti*, the law of corporate social responsibility developed independently of the first amendment. The impact of this first amendment case upon the law of corporate social responsibility, however, is clear. A state may not prevent corporate management from using corporate funds to propagate views having no connection with the corporate business. The first amendment guarantees corporate managers the right to use corporate funds to circulate fact and opinion irrelevant to the business placed in their charge and representing their own personal views about political and social questions. Once having established this point, and given the pressures that exist to permit the use of such funds to advance social causes generally, there is little reason to confine the doctrine to use of funds to influence a vote. From the standpoint of the shareholder who claims these same funds as his own, there is no difference between the use of the funds to effect a vote on a social issue and the use of the same funds to execute a social policy. This argument has persuasive force, but the question of corporate expenditure for a purpose not related to its business and made to accomplish a social cause *directly* rather than an expenditure made to convince others to vote in favor of that cause would have to be addressed expressly before the rule of law with which this article is concerned could be considered clear. The reasons for this decision, grounded in the first amendment, are different than those previously

\(^{51}\) Id. at 794-95 n.34.  
\(^{52}\) Id. at 785 n.21.  
\(^{53}\) Id.
encountered in the field of corporate social responsibility. However, the close relationship that exists in fields of social activity between the activity itself and shaping public opinion relating to that activity, means that the impact of this decision should be enormous upon permissible corporate social activity.

The cases noted since the Ford case have chipped away at the doctrine therein expressed. Bellotti, through the medium of the first amendment, takes a giant step forward. It could be narrowly construed, but it may afford the thrust that is needed at this time to establish a broad new standard.

To the extent indicated and qualified above, permission for corporate altruism presently exists. The traditional requirement of benefit to the corporation in order to validate a corporate expenditure is rooted in large part upon the advantage this test has with reference to accountability. A test which consists of the sole pursuit of shareholder interests, except where otherwise specifically authorized by statute, is easily applied when short term benefit is involved. On the other hand, almost any expenditure can be justified as being of long-term benefit to a corporation when the argument is advanced that a good social, economic, and political climate is a positive factor in the long-term success of a business. In reality, it often becomes impossible to distinguish between an expenditure which has as its purpose a desire to aid what the corporation believes to be a worthwhile cause, and has no other purpose, and an expenditure which has as its purpose long-term benefit to a corporation justified on the basis that a good social, economic, and political climate is a positive factor in the long-term success of a business. In reality, these two principles merge. In order to avoid litigation and liability, it is common for corporate executives to use the protection of the long-term benefit theory to validate what is really an altruistic motive, and such altruistic motives often exist. As stated by Mr. Harriman, Chairman of the Board of the Union Pacific Railroad Company, and noted in Union Pacific Railroad Co. v. Trustees, Inc.:

We have also come to the conclusion there is a general public acceptance of the idea that corporations should act like public-spirited citizens and cannot seek always to put the gift on a quid pro quo basis.54

It is submitted that a legal standard that does not meet the test of reality and intellectual honesty should be discarded in favor of one that does. The development of the law in the field of corporate social responsibility is reminiscent of the development of the law towards the

54. 8 Utah 2d at 112, 329 P.2d at 405.
theory of strict liability. In order to obtain a socially desirable result in products liability cases, the courts for many years permitted recovery for breach of warranty without privity of contract. This was a pragmatic but intellectually dishonest approach. Eventually the courts, realizing that the reasoning used to achieve the result was strained, recognized recovery on the basis of a new theory, strict tort liability. Chief Justice Burger stated in June, 1979 “[B]eware the ‘good results’ achieved by judicially unauthorized or intellectually dishonest means. . .”56 Altrustic social activity, often sustained on the ground of long term benefit and often claimed by management to be of long-term benefit to the corporation in order to avoid the legal question of its validity, should be sustained instead by an honest recognition of a new standard.

THE CONCEPT OF ACCOUNTABILITY

If the profit motive is rejected as the sole guiding principle for corporate action and social betterment is considered an additional guide, the traditional legal notions of management's fiduciary obligation to its shareholders must be altered. If the system of controls based upon profit maximization alone is discarded, consideration must be given to what the new controls will be.

It is certainly difficult to quantify the effect upon a corporation of behavior that may be categorized as altrustic or as undertaken in view of a long-range profit potential. But this is not a novel situation. It is no easier to quantify the effect of many research and development or advertising programs. Undoubtedly, the addition of social responsibility to the functions of management would increase the difficulty of evaluating management's performance. We would no longer have a mathematical test, profit, by which to judge management. This has been advanced as a serious objection to the inclusion of corporate social responsibility as a legitimate additional goal of management. The problem is a formidable one, but given the need for change, and the extent of pressure for a change, it need not be unsolvable. A diffusion of managerial responsibilities would not result in arbitrary decision-making but would reflect decisionmaking that is responsive to wider expectations of shareholders, customers, and others, probably exactly in relation to the force that diverse elements are able to bring upon the corporation and the market price of the stock.

There should be no substantial fear of a wholesale diversion of cor-

porate assets for social purposes to the detriment of profits. In addition to the internal procedures that exist for change of corporate management where corporate action runs consistently contrary to the desires of shareholders, there is the effect of shareholders' displeasure upon the market price of the stock. If corporate involvement in the social sphere results in lesser earnings, or otherwise reaches the point where shareholders become dissatisfied, sale of the stock and resultant market pressure would reduce the price of the stock. This would normally be unacceptable to management, both because management would become vulnerable to replacement by internal means and because a lower stock market price would make management vulnerable to a takeover. Other factors that will cause management to concentrate heavily on profits, even if social obligations were made a legitimate additional corporate goal are, one, that poor market performance of the stock will make it more difficult to obtain capital both through sale of new securities and through bank loans; and two, that failure of the stock price to rise will prevent management from realizing hoped-for gain from stock options.

On the other hand, it is unlikely to expect a selling wave in a profitable company, despite involvement in social problems. Thus, if profit is not the only test for permissible corporate expenditures, a healthy balance is likely to result between expenditures designed to produce profit and expenditures designed to produce social good. The exact balance should reflect the views of society and of shareholders and managers who are members of that society as to the relative importance of each factor. As to the interplay of forces, it should not be forgotten that shareholders increasingly represent a cross-section of American life, and the views of shareholders are often more aligned with the interests of the general public than of the corporation. The possibly near-perfect action of the market will reflect the degree of positive interest of shareholders and prospective buyers of stock in the social performance of the corporation. It is only when their collective judgment is negative that the stock price will decline.

A change in the legal test of management's function, for another reason, would not result in quite the radical change in our economy that some may predict. At the present time, the commercial importance of all levels of government to business, and the vast actual and potential governmental regulatory power over business, makes government approval dependent upon adherence to governmental policy and objectives of major significance to business. Modern management also knows that it runs the risk of serious consequences if it adopts policies that important social groups consider to be adverse to their, or to the
general public's interest. To the extent that management is presently sensitive to governmental policy and social issues, the recognition of a legal standard that would permit action based thereon would legitimize rather than change the present operation of our economic system.

Accountability would be enhanced by requiring two safeguards. First, if corporate altruism is to be controlled by the effect of shareholder disapproval, then formal action by the board of directors that would feel the effect of disapproval, should be required for any expenditure that involves a significant percentage of corporate assets. Lesser sums could be approved by corporate officers alone. The particular percentage could be established by statute, but preferably, in view of the varied factors that may exist in individual cases, this could be left to judicial determination. Secondly, the effectiveness of shareholder disapproval would be served by Securities and Exchange Commission regulations requiring disclosure of corporate altruism. This public disclosure would tend to limit abuses of discretion while not stifling beneficial programs. Public disclosure, and the attendant public as well as intercompany discussion that would result, would tend to develop a consensus approach to corporate altruistic activity. This recognizes that people operate subject to both legal and social control that is beyond the enforcing mechanism of the legal system.

The social performance disclosure question is receiving the attention of the accounting profession. There is a recognition of the need to develop methods of measuring, assessing, and controlling the social performance of private enterprise with respect to issues such as environmental protection, racial and sexual discrimination, and consumer policies. This involves theories, criteria, and methodologies to measure and report on aspects of corporate social performance. The incentive for this endeavor is a view among investors that a moderate to strong association exists between the investment value of a company's shares and its social performance. A study by Professor Barry Spicer reported in January, 1978\(^5\) notes an increase in the number of investors who

\begin{quote}
on the basis of moral or ethical predilections (or because of pressure from various sources), believe they should avoid investing in certain classes of corporations, i.e., those that are thought to be causing social injury or environmental damage of one type or another.\(^5\)
\end{quote}

This includes a large number of influential institutional investors. The study notes the establishment of "clean mutual funds, the investment

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58. Id. at 96.
objectives of which explicitly include social objectives or criteria.\textsuperscript{59} The concept of merger between pure altruism and long-term profit, previously noted, is here reinforced with the statement, "a long-term economic perspective necessarily involves some social considerations, since a company with egregious pollution or employment problems is likely to bear economic consequences at a future date."\textsuperscript{60} Professor Spicer concludes that

any complete measure of corporate social performance would require (1) the specification of those factors or components that can properly be said to be a part of a corporation's social performance; (2) the measurement of performance with respect to each of these factors or components; and (3) the summarization of these measures into a vector of indices or one overall index of some type.\textsuperscript{61}

For his study Professor Spicer chose corporation records with respect to pollution control. As a result of his empirical investigation, Professor Spicer concluded that

[s]ome statistically significant associations were shown to exist between corporations' pollution-control records (as defined in the study) and a number of other financial or economic variables of interest. Specifically, it was found that, for a sample drawn from the pulp and paper industry, companies with better pollution-control records tend to have higher profitability, larger size, lower total risk, lower systematic risk and higher price/earnings ratios than companies with poorer pollution-control records.\textsuperscript{62}

Two particularly significant points are evident in Professor Spicer's work. First, the fact that a corporation's performance in the social sphere is shown to have a positive relationship to the value of its shares and its profitability bolsters the contention here made that in fact there is often a merger between altruism and profit motivation, and that it is unrealistic to attempt to apply a legal standard which ignores altruism as a justifiable motive for corporate expenditures. Secondly, with respect to the problem of directors' accountability for the corporation's social activity, the accounting profession is engaged in beginning to formulate techniques to measure that performance. Professor Spicer states that this "foreshadows both a fundamental change in disclosure philosophy and a significant expansion in the subject matter of accounting."\textsuperscript{63}

\textsuperscript{59} Id.
\textsuperscript{60} B. Longstreth and H. Rosenbloom, Corporate Social Responsibility and the Institutional Investor 62-63 (1973).
\textsuperscript{62} Id. at 109.
\textsuperscript{63} Id. at 95.
In the transition from a rule of profit maximization to a rule which allows, additionally, expenditures to advance social ends not related to profit, we should not be overly concerned that we have moved from an objective test to one not capable of strict application. However objective the profit maximization test may appear, it has never been susceptible of strict application. It cannot be determined if profit has been really maximized. It has never been anything more than a goal. Reasonable men do differ about the results of an action taken in the name of profit maximization. Reasonable men will differ about the propriety and results of action taken in the name of social benefit. Neither test can do more, in the context of imperfect knowledge, than to provide a theoretical framework within which to bring judgment to bear.

The New Reality Requires the Recognition of a New Standard

It has traditionally been argued that society has created institutions such as government and charitable organizations to assume the responsibility of administering to social needs. This theory worked well in the early years of our economic development and before the emergence of the modern corporate giants. Business involvement in social issues and the pressure of society and of special interest groups for greater involvement impliedly rejects this traditional division of responsibility. Business involvement in the social sphere is being demanded by students, environmentalists, consumer advocates, groups concerned with inflation, unemployment, poverty, and the numerous other social issues of our time. As a result, fundamental questions have been raised about the structure of our society. These voices will not be stilled by a response that the business of business is profit, and business will not be permitted to survive in its old form. It is not naive, but realistic, to take account of the world we are now living in, and formally legitimize corporate social activity that does exist now and must exist in the future to a greater extent.

When a large segment of society views shareholders as no longer being the only group for whose benefit a corporation must act, but as only one interest group, and demands that management must promote the interests of society as well, then a significant change has taken place in the reality of corporations. Corporate altruistic action has reached, or evidently at least may shortly reach, such proportions that the straining of existing legal norms becomes inadequate for the guidance of business. Realistic legal standards must evolve to match what is really happening.

Much corporate action is susceptible to interpretation either as altru-
istic or profit oriented. Corporate action in aid of governmental policy, for example, an agreement not to raise prices in order to counter inflation, even if done for its avowed purpose (i.e., actually altruistic) can be defended on the ground of narrow corporate benefit, thus compounding the difficulty of determining motive. Large corporations are vulnerable to governmental pressure because of the threat of antitrust and other unwanted regulation. When such pressure is brought to bear, either explicitly or subtly, management can argue that the action is justified under the benefit test, because failure to accede to the pressure may result in serious adverse effects through future legislation, administrative action or more vigorous enforcement of existing laws. This argument is real, but it can also be used to justify purely altruistic activity under the benefit test if management wishes to so cover itself under older and more predictable legal theory. Where the intention is to perform altruistic activity, it should not be made necessary, and is in fact dishonest, to present the activity as if it were profit oriented.

The test of profit maximization is convenient. One of its most positive attributes has been that it affords managers protection from liability if they observe it. It is a safe rule for a businessperson to follow. We should not, however, continue to subscribe to the test of profit maximization merely because it is an easy test, if in fact the test no longer truthfully fulfills the needs of society. We should not indulge in legal fiction to defend a reasonable, socially desirable policy that the public demands.

It is, of course, a first concern of management that its capital be used profitably, or there would shortly be no capital. At some point beyond that, the entity to whom society has entrusted its major resources must be responsive to the larger needs of society. The role of business, the efficient use of resources to produce the maximum benefit for society, is only meaningful if it includes by definition both the social and economic benefits. From the strictly selfish standpoint of the business community, it must be recognized that unless the possessors of society’s major resources take up the challenge of society’s problems, society will not forever tolerate the continued entrustment of society’s resources to private enterprise. Ever increasing elements of our society now require that the repositories of wealth and power directly address the responsibilities which are deemed to be inherent in the possession of such wealth and power. Significant segments of management agree.

No attempt is made here to minimize the profit motive as the chief force behind our economic system. Yet to claim that it is the only force at work is to be simplistic. The fact is that human beings, both on and off boards of directors, often encounter situations in which they simply
believe that a certain course of action is the decent course to pursue. Whether the motivating force is ethics, morals, religion, social consciousness, or innate decency matters little. The point is that it is not always a profit motive. It is, therefore, both unrealistic and disturbing for our legal system to require that such action always be defended on the theory of benefit to the corporation. It would be better to restate the law of corporate fiduciary responsibility in terms which take into full account the social philosophy of our time. The responsibility of management, as defined by its legal parameters, must include, in addition to its immediate profit objective, broad authority to act in securing social benefits.

To forestall the possibility, probably remote, that sudden substantial altruistic activity would take shareholders unaware and dissipate a large portion of their investment, it would be prudent to impose a limitation of reasonableness upon the grant of a broad power to engage in altruistic social activity. A limitation of reasonableness is one familiar to our judicial system. It would serve the limiting purpose indicated above, and yet allow for development as our socio-economic philosophy changes. Under this test, the amount of an expenditure can be weighed against factors such as the assets and income of the donor with due regard to the social goals sought to be achieved. In this expanded context, a business judgment test would continue to insulate the courts from detailed review of most activity, and yet provide a method of preventing extreme and totally unexpected action.

Aside from the development of the law in particular jurisdictions as noted in this article, strict pursuit of shareholder interest remains the legal standard applied to determine the parameters of permissible corporate social activity. At present, it is only to the extent herein indicated that corporate activity not related to profit falls within the bounds of legality.

A failure to allow the huge concentrations of wealth and power which are our corporations to use their funds in the pursuit of social betterment in a pluralistic fashion will only result in a greater concentration of power and wealth in government. Society will insist that its goals be reached. Our choice is that of pursuing the goals solely through ever larger bureaucratic government, or, in addition, through the pluralistic device of the almost unlimited actual and potential imagination of our business community.

We have reached a point in our social consciousness where, despite the difficulties involved, we must, to honestly reflect reality, embrace a bold public obligation theory. The creation or recognition of a legal standard which would honestly permit the use of corporate funds for
social purposes not related to profit, should not cause concern that this standard would encourage an abandonment of profit seeking as a major or the major corporate purpose. The degree of corporate altruism will without doubt be responsive to the balance which exists between our society's desire for profit and social betterment. Management's decisions will continue to be influenced heavily by the profit-seeking desires of shareholders. Undoubtedly, one of the strongest objectives of management is to remain in power. But profit is not the only thing sought by society, as that society is composed of shareholders and managers and others. Management should be allowed to be legally responsive to all of the aims of our society including all of the aims of its shareholders.

We must recognize, as stated by Justice Worthen in his dissent in Union Pacific Railroad Co. v. Trustees, Inc., that corporate expenditures in the social sphere are not always made in expectation of a quid pro quo, but that often "the real purpose of these public spirited directors is their desire to aid worthwhile causes that need their assistance."64

It would be preferable, for the sake of certainty, for the states to amend their corporation law to grant specifically broad power for corporate expenditures for social benefit, not related to profit, limited only by a test of reasonableness. Such legislation is, however, not essential in order to permit such expenditures. As stated by Justice Jacobs of the Supreme Court of New Jersey:

The genius of our common law has been its capacity for growth and its adaptability to the needs of the times. Generally courts have accomplished the desired results indirectly through the molding of old forms. Occasionally they have done it directly through frank rejection of the old and recognition of the new. But whichever path the common law has taken it has not been found wanting as the proper tool for the advancement of the general good.65

However it is accomplished, by statute or by the development of the common law, the legal standard of permitted corporate activity must include expenditures not related to profit, so as to conform to society's present expectation of corporate social responsibility.

64. 8 Utah 2d at 112, 329 P.2d at 405 (1958).